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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1934.

No. 600

HARRY E. HALLENBECK, RECEIVER OF SOUTH ASHLAND NATIONAL BANK,

Petitioner,

vs.

W. F. LEIMERT, RECEIVER OF CENTRAL MANUFACTURING DISTRICT BANK,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

AND

BRIEF IN SUPPORT THEREOF.

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THE BLAKEMORE-WARNER PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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BRIEF IN SUPPORT THEREOF.

To the Honorable Charles Evans Hughes, Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Harry E. Hallenbeck, receiver of South Ashland National Bank, respectfully represents:

SUMMARY STATEMENT OF THE MATTER INVOLVED.

The respondent, W. F. Leimert, Receiver of Central Manufacturing District Bank, filed suit in the District Court for the Northern District of Illinois, to recover the amount

paid on five checks, aggregating $13,733 (Rec., 2-11). The cause was tried before the District Judge, sitting without a jury, and special findings of fact and conclusions of law were made and filed of record by the court (Rec., 19-22). The facts as found by the court are substantially as follows:

The petitioner, the Ashland Bank, was the payee or endorsee of five checks drawn on the respondent, the Central Bank, aggregating $13,733 (Rec., 19-20). The Ashland Bank endorsed one check without qualification (Rec., 12) and deposited it in the First National Bank of Chicago, where both the Central Bank and the Ashland Bank maintained accounts (Rec., 20-21). The First National Bank credited the Ashland Bank and debited the Central Bank for the amount of the check. The check was then sent by messenger to the Central Bank and arrived there some time after noon of the same day. The Central Bank received the check and although its payment would create an overdraft in the drawer's account did not return it to the First National Bank that day, or in fact, at any time thereafter, and never made a claim against the First National Bank for a cancellation of the debit to its account. The next morning, the Central Bank, presented the check at the Ashland Bank and demanded reimbursement for the amount charged to the account of the Central Bank in the First National Bank, which demand was refused (Rec., 21).

The other four checks were endorsed by the Ashland Bank without qualification (R. 11-14) and deposited in the Federal Reserve Bank of Chicago (Rec., 20). The Federal Reserve Bank was a member of, and the Central Bank an affiliated member of the Chicago Clearing House Association. The Ashland Bank was neither a member, nor an affiliated member (R. 20). A rule of the Clearing House in force at that time provided that in order that the member banks presenting checks for payment through the Clearing

House might have an opportunity to give special instructions as to the protest of unpaid items, notice of nonpayment of any such items drawn on the affiliated member banks be given by telephone before 2:30 P. M. of the same day to the member bank presenting such items through the Clearing House (Rec., 21). The Federal Reserve Bank presented the four checks to the Central Bank for payment through the Clearing House. The Central Bank received these checks about 11:30 A. M. and in accordance with the Clearing House practice, paid them by its check, although the payment created an overdraft in the drawer's account (Rec., 20). It did not notify the Clearing House or the Federal Reserve Bank of the insufficiency of the drawer's funds or return the checks to the Federal Reserve Bank by 2:30 P. M. of that day, or, as a matter of fact, at any time thereafter. The next morning the Central Bank presented these four checks to the Ashland Bank and demanded reimbursement. The Ashland Bank got and kept the proceeds of all five checks (Rec., 20-21).

Judgment was entered for the Central Bank against the Ashland Bank in the sum of $14,864.56 (Rec., 24). On appeal to the Circuit Court of Appeals for the Seventh Circuit the judgment was affirmed (Rec., 38). Rehearing was denied (Rec., 40).

Decisions of the District Court and the Circuit Court of Appeals.

The District Court concluded as a matter of law that the payment through the Clearing House and the exchange of credits on the books of the First National Bank did not operate as payment of the checks; that the checks, therefore, were dishonored; that the notice given by the Central Bank to the Ashland Bank on the day after presentment for payment "was in compliance with Section

102 of the Negotiable Instruments Law and fixed the liability of the South Ashland National Bank to reimburse the Central Manufacturing District Bank for the amount of the checks" (Rec., 22). The Circuit Court of Appeals affirmed these holdings and in its opinion said that the Ashland Bank, not being a member of the Clearing House, could take no advantage of their rules, and that accordingly, the failure of the Central Bank to notify the collecting bank within the time prescribed by the rules, or at any time, or to return the checks to the collecting bank, did not result in the payment becoming final; that the checks not being paid, all that was necessary for the Central Bank to do to hold the Ashland Bank was to give the Ashland Bank notice of dishonor within the time provided by Section 102 of the Negotiable Instruments Law, and that "The notice given by the Central Bank to the Ashland Bank was in compliance with the terms of the Negotiable Instruments Law and the Ashland Bank was properly held liable to reimburse the Central Bank for the amount of the checks" (Rec., 38).

The decisions of the District Court and the Circuit Court of Appeals in this case squarely base the right of the Central Bank to recover of the Ashland Bank, the money paid by the Central Bank to the collecting bank and received from the collecting bank by the Ashland Bank, on proper notice of dishonor under the Negotiable Instruments Law. They decide first that the checks were dishonored by nonpayment and that, therefore, notice of dishonor was necessary to fix a liability in the endorser to reimburse the drawee, and that this notice of dishonor was properly given. The decision was not based on any doctrine of the recovery of a payment made through fraud or mutual mistake or to one not receiving the payment in good faith.

It is the contention of petitioner (1) that the payment through the Clearing House resulted in a payment of the

instrument and a discharge of the secondary liability of endorsers thereon, and, (2) that whether the instrument was paid, or dishonored by nonpayment, notice of dishonor has no application to and neither creates nor fixes any rights in a drawee of a check as against a payee or endorser; that an endorser assumes no obligation by his endorsement as to the drawee, and that whatever rights a drawee might have to recover a payment made on a check are independent of and unaffected by the notice of dishonor provisions of the Negotiable Instruments Law.

Statutes Involved.

Section 66 of the Uniform Negotiable Instruments Law (in Illinois found in Chap. 98, Cahill Illinois Revised Statutes 1933, Par. 86) fixing the liability assumed by endorsers by their endorsement, provides, as far as material:

> "And, in addition, every endorser engages that on due presentment, it (the instrument) shall be accepted or paid, or both, as the case may be, according to its tenor, and that if it be dishonored and the necessary proceedings on dishonor be duly taken he will pay the amount thereof to the holder, or to any subsequent endorser who may be compelled to pay it."

Section 88 (Chap. 98, Cahill Illinois Revised Statutes 1933, Par. 110) provides:

> "When a negotiable instrument has been dishonored by nonacceptance or nonpayment, notice of dishonor must be given to the drawer and to each endorser, and any drawer or endorser to whom such notice is not given is discharged."

Section 102 (Chap. 98, Cahill Illinois Revised Statutes 1933, Par. 124) provides that the notice of dishonor required by Section 88 "must be given before the close of business hours on the day following" dishonor.

Questions Presented.

(1) Under the general law of negotiable instruments as codified by the Uniform Negotiable Instruments Law does a drawee of a check acquire any rights against an indorser by virtue of giving notice of dishonor?

(2) Where checks are paid through Clearing House Associations, which have rules allowing drawee banks a specified time in which to examine checks drawn on them and to notify collecting member banks if they desire to rescind any payment, and a drawee bank pays the amount of a check presented to it through the Clearing House by a collecting member bank and does not notify the collecting bank within the specified time, or at any time, that it desires to rescind the payment, and the collecting bank remits the same to a depositing indorser who is not a member of the Clearing House, is the payment final and irrevocable as between the drawee bank and the depositing indorser?

Reasons Relied On for Allowance of Writ.

(1) In holding that a drawee of a check, by giving notice of dishonor of the check, secures rights against a prior endorser, the Circuit Court of Appeals has decided an important question of general commercial law in a way probably untenable and in conflict with the weight of authority. The Uniform Negotiable Instruments Law, with minor variations, has been adopted in all of the states of the Union and governs the vast number and amount of payments and transfers of funds by means of negotiable instruments. Uniformity and soundness of decision under this law are of great importance and of far-reaching effect and are not a matter of mere local law. The decision of the Circuit Court of Appeals that a drawee may give notice of dishonor under the Negotiable Instruments Law and thus acquire

rights against an endorser, is contrary to the great weight of authority in this country to the effect that an endorser, by his endorsement, assumes a liability only to subsequent holders, and that a drawee who receives a check for payment is not a holder. It is probably untenable also, as will appear from the supporting brief, in that notice of dishonor under the Negotiable Instruments Law is given only to fix the secondary liability of an endorser to parties prior to the drawee, in the event the drawee does not pay the check upon presentment, and has no application to a case where a drawee is seeking to recover funds already paid. As far as petitioner has been able to determine, it has never before been held that notice of dishonor in any way created any rights in a drawee of a check and we respectfully submit that the question here presented should be considered and determined by this court in the interest of uniformity and soundness of decision under the Uniform Negotiable Instruments Law.

(2) In deciding that payment of a check by a drawee bank, made through a Clearing-House to a collecting bank, may be recovered against a prior endorser who deposited the check in the collecting bank and received the proceeds of the collection, the Circuit Court of Appeals has decided an important question of general law in a way probably untenable and contrary to the weight of authority. The decision is contrary in principle to the decision of this court in *American National Bank* v. *Miller*, 229 U. S. 517, 33 S. Ct. 883, 57 L. Ed. 1310, where this court held that when a drawee bank accepts as a credit to a depositor a check drawn on, and presented to it for payment, the transaction is closed and in the absence of fraud or mutual mistake, is irrevocable. In the present case the drawee, upon presentation of the checks to it for payment through the Clearing House, paid them upon the condition that the payment could be revoked by a certain time. It did

not revoke the payment by that time and the payment then became the same as an unconditional payment. Under the principle of the above case, it would seem this could not be revoked except for fraud or mutual mistake. No fraud or mutual mistake was alleged or relied upon by the Circuit Court of Appeals. The decision is also contrary in principle to the decision of this court in *National Bank* v. *Burkhardt*, 100 U. S. 686 (689), 25 L. Ed. 766; also, to the decision of the Circuit Court of Appeals, for the Second Circuit, in *Riverside Bank* v. *First National Bank of Shenandoah*, 74 Fed. 276, a case holding that a payment of a check by the drawee bank under misapprehension as to the state of the drawer's account, cannot be recovered back from the holder. As will appear from petitioner's brief, the great weight of authority in this country is to the effect that the payment of a check by a drawee, resulting in an overdraft, cannot be recovered from the party to whom paid and *a fortiori* from a prior endorser when the payment was not made to him but to the bank to whom he endorsed it. In view of the fact that most payments of checks in large cities are made through clearing house associations, we respectfully submit the question here involved is of great importance.

Petitioner believes that because of the importance of the questions involved, the importance of uniformity and sound decision under the Uniform Negotiable Instruments Law and the conflict with prior decisions of this court and with the weight of authority in this country on a general question of law, this case should be considered by this court.

Wherefore, petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals, for the Seventh Circuit, demanding said Court to certify and send to this court a full transcript of record

and proceedings of said Circuit Court of Appeals in said cause, Harry E. Hallenbeck, Receiver of South Ashland National Bank, *vs.* W. F. Leimert, Receiver of Central Manufacturing District Bank, No. 5185; that said cause be reviewed and determined by this court, the decision of said Circuit Court of Appeals be reversed by this Honorable Court, and that your petitioners have such other relief as may appear appropriate.

HARRY E. HALLENBECK,
Receiver of South Ashland National Bank,
By WALTER T. FISHER,
His Attorney.

SUPPORTING BRIEF.

Opinions of Courts Below.

District Court: Findings of fact (Rec., 19-22); Conclusions of law (Rec., 19-22); Judgment (Rec., 24).

Circuit Court of Appeals: Opinion (Rec., 35-38), 72 Fed. (2nd) 480.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229 (43 Stat. 938 (28 U. S. C. A. Sec. 347)); Petition for rehearing denied September 28, 1934. (Rec., 40.)

STATEMENT OF FACTS.

The facts are stated in the petition, pages 1-3.

SPECIFICATION OF ERRORS.

(1) The Circuit Court of Appeals erred in holding that the notice of dishonor given under Section 102 of the Negotiable Instruments Law created or fixed any right in the drawee of the five checks as against the payee or endorser.

(2) The Circuit Court of Appeals erred in holding that the checks were not paid.

BRIEF AND ARGUMENT.

I.

THE DISHONOR PROVISIONS OF THE NEGOTIABLE INSTRUMENTS LAW HAVE NO APPLICATION TO AND NEITHER CREATE NOR FIX ANY RIGHTS IN THE DRAWEE OF A CHECK AS AGAINST THE PAYEE OR ENDORSER.

(a) The presentment of a check to the drawee for payment is not a negotiation and the drawee does not become a holder.

Figuers v. *Fly*, 137 Tenn. 358; 193 S. W. 117.

National Bank of Commerce v. *Seattle National Bank*, 109 Wash. 312; 187 Pac. 342.

First National Bank v. *Brule National Bank*, 41 South Dakota 87; 168 N. W. 1054.

Brannan's Negotiable Instruments Law, 5th Ed. 748.

Louisa National Bank v. *Kentucky National Bank*, 293 Kentucky 302; 39 S. W. (2nd) 497.

"'Holder' refers to one who has taken the instrument as it passes along in the course of negotiation towards the drawee and not the latter." *National Bank of Commerce* v. *Seattle National Bank*, 109 Wash. 312; 187 Pac. 342, at 346.

(b) Section 84 of the Negotiable Instruments Act (Chap. 98, Cahill Illinois Revised Statutes, 1933, Par. 106) provides:

"When the instrument is dishonored by nonpayment, an immediate right of recourse to all parties secondarily liable thereon accrues to the holder."

Section 88 of the same Act (Cahill Illinois Revised Statutes 1933, Par. 110) provides that when a negotiable in-

strument has been dishonored by non-payment "notice of dishonor must be given to the drawer and to each endorser, and any drawer or endorser to whom such notice is not given is discharged."

Section 102 of the same Act (Cahill Illinois Revised Statutes 1933, Par 124) provides the time within which this notice of dishonor must be given.

The Circuit Court of Appeals based and conditioned the right of recovery of the Central Bank, the drawee of the check, on giving due notice of dishonor to the Ashland Bank, the payee-endorser. The above citations make it clear that notice of dishonor is given only to fix the secondary liability of the endorser to a *holder*, who has presented it to the drawee and has been refused payment. These citations further make it clear that there is no secondary liability, except to a *holder* and that the drawee is not a *holder*. Section 89 of the Negotiable Instruments Law (Cahill Illinois Revised Statutes 1933, Par. 111) providing who may give notice of dishonor would seem to be conclusive. It provides "the notice may be given by or on behalf of the holder or by or on behalf of any party to the instrument who might be compelled to pay it to the holder." The drawee not being a holder has no authority under the Negotiable Instruments Law to give notice on his own behalf, nor is he a party who might be compelled to pay it to the holder, because a drawee has no liability to the holder unless and until he certifies the check (Cahill Illinois Revised Statutes 1933, Par. 210). Furthermore, it would seem to be an absurdity to hold that the engagement assumed by an endorser by his endorsement of the instrument that it will be paid on presentment to the drawee is an engagement with the drawee—the very party who is to pay the check.

Consequently, it would seem clearly untenable to hold as

was done by the Circuit Court of Appeals that notice of dishonor could be given by a drawee, so as to create any rights in it as against a prior endorser.

II.

THE PAYMENT MADE THROUGH THE CLEARING HOUSE ASSOCIATION RESULTED IN FINAL AND IRREVOCABLE PAYMENT OF THE CHECKS.

National Exchange Bank v. *Ginn & Co.*, 114 Md. 181; 78 Atl. 1026.

In that case the collecting bank presented a check through the Clearing House to the drawee bank. The check was paid by the drawee bank and was not returned to the collecting bank within the time allowed by the Clearing House rules. The Court held that the check not having been returned within the allowed time, the Clearing House settlement amounted to the same thing as payment over the counter, was final and irrevocable and could not be recovered against the prior endorser who deposited the check in the collecting bank.

In the absence of fraud or mutual mistake, the payment of a check by a bank upon which it is drawn, even under the mistaken belief that the drawer has sufficient funds to his credit to pay the check, cannot be recovered from the payee by the bank paying the check.

American National Bank of Nashville, Tenn. v. *Miller*, 229 U. S. 517; 33 S. Ct. 883; 57 L. Ed. 1310.

Riverside Bank v. *First National Bank of Shenandoah*, 74 Fed. 226; 20 C. C. A. 181.

National Exchange Bank v. *Ginn & Co.*, 114 Md. 181; 78 Atl. 1026.

First National Bank of Denver v. *Devenish*, 15 Colo. 229; 25 Pac. 177.

Bank v. *Burkham*, 32 Mich. 328.

And *a fortiori* payment cannot be recovered, where a payee after endorsing a check generally deposits it to his account in his bank by which it is forwarded to the drawee bank and the latter pays it by mistake, as there is no privity between the paying bank and the payee to support an action to recover money paid by mistake.

National Bank of New Jersey v. *Berrall*, 70 N. J. 757; 58 Atl. 189; 66 L. R. A. 599; 95.
5 Ruling Case Law, Par. 95, Page 571.

In the case at bar the payment sought to be recovered was not made to the Ashland Bank, but to the collecting bank who paid it over to the Ashland Bank. (Rec., 20-21.)

The Central Bank voluntarily paid the checks and voluntarily allowed the time to pass within which, under the rules of the Clearing House Association of which it was a member, it could return the checks if it did not intend the payment to become final. It thus intentionally allowed the payment to become final and is in no different situation than any drawee who has paid a check in cash or given an unconditional credit.

In *Preston* v. *Canadian Bank of Commerce*, 23 Fed. 179, the Circuit Court of Appeals for the Seventh Circuit held that a drawee bank who pays a check to the collecting bank through the Clearing House, and does not rescind the payment within the time allowed by the rules, could not recover the same from the collecting bank. It is difficult to see how the fact that the collecting bank paid the proceeds over to a depositing endorser could change the effect of the payment, or how a check could be paid as to one party and not as to another, no question of fraud or good faith being involved.

III.

THE EXCHANGE OF CREDITS ON THE BOOKS OF THE FIRST NATIONAL BANK AND THE FAILURE OF THE CENTRAL BANK TO REPUDIATE PAYMENT IN THAT METHOD RESULTED IN PAYMENT OF THE CHECK.

American National Bank v. *Miller*, 229 U. S. 517; 33 S. Ct. 883; 57 L. Ed. 1310.

National Bank v. *Burkhardt*, 100 U. S. 686; 25 L. Ed. 766.

The First National Bank on receiving the check endorsed by the Ashland Bank, debited the account of the Central Bank and then sent the check to the Central Bank for payment. The Central Bank accepted the check and never at any time returned it to the First National Bank and thus accepted the debit to its account and sued the Ashland Bank to recover the amount of this debit. It thus accepted this debit as a final debit as far as the First National Bank was concerned, thus ratifying this method of payment to the First National Bank. It is the same in legal effect as though the Central Bank on receiving the checks had given the collecting bank an unconditional credit on its books for the amount of the check. The cases cited above make it clear that this amounts to payment and cannot be revoked, except for fraud or mutual mistake.

Examination of the pleadings make it clear that the declaration filed in this case is not based on the recovery of money paid by mutual mistake or fraud, and both the declaration and the decisions of the District Court and the Circuit Court of Appeals are based on the theory that the checks were not paid. Respondent is bound by his declaration. Furthermore no facts are found by the court which

would justify such a decision even apart from the pleadings.

Respectfully submitted,

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